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FOR HEDGE FUND INVESTORS AND MANAGERS

Innovation
Guggenheim Advisors' bespoke solution to funds of hedge funds

Revolution
Angelo Gordon's bet on long-only management

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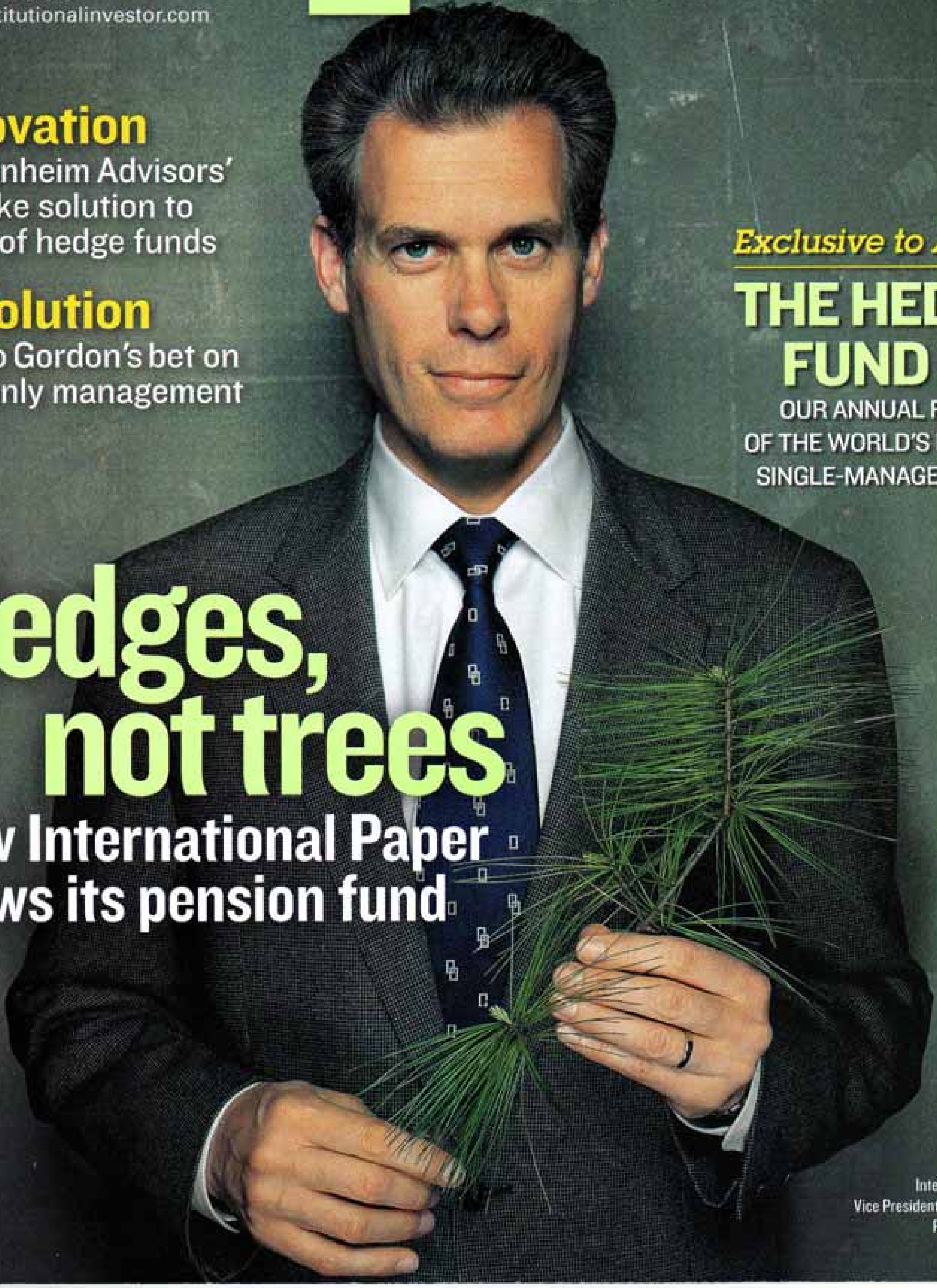
Hedges, not trees
How International Paper grows its pension fund



International Paper
Vice President of Investments
Robert Hunkeler

Alpha

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Send in the Clones

FOR MANY PENSION FUND MANAGERS, hedge funds are a conundrum. Alluring for the promise of pure alpha they offer, as well as for the diversification benefits they can provide, hedge funds also have a much-deserved reputation for high fees and opacity, making the decision to invest in them a potentially difficult one.

Not so for Robert Hunkeler, who manages International Paper Co.'s $7 billion pension fund. A former research chemist, Hunkeler sees hedge funds as invaluable generators of alpha that can be mixed and matched with traditional investments to create higher risk-adjusted returns. Hunkeler has allocated $350 million to hedge funds in a portable alpha strategy designed to enhance the return of his pension plan's large-cap U.S. equities portfolio.

As Contributing Writer Frances Denmark reports in "Out of the Woods," starting on page 18, Hunkeler is getting ready to double his allocation to hedge funds. This time, the alpha they generate will go to boosting the returns of the pension plan's fixed-income investments. If successful, Hunkeler could help reduce the $2.3 billion unfunded pension liability at International Paper.

When Hunkeler created his portable alpha program in 2003, he used a combination of funds of hedge funds and multistrategy single-manager funds. His new allocation, however, will be composed exclusively of multistrategy funds — not only to avoid the second set of fees but also to give him greater ability to customize his portfolio.

In "Guggenheim Exhibit" (page 34), Senior Contributing Editor Harvey D. Shapiro chronicles one fund-of-funds firm that has tailored its business to satisfy the needs of investors like Hunkeler. Guggenheim Advisors, founded by the Guggenheim family office, sets up separate accounts with individual hedge funds and uses them to construct customized fund-of-funds portfolios for clients. With $3 billion in assets, Guggenheim Advisors and its bespoke solution appeal to a segment of the market willing to pay an extra layer of fees.

Andrew W. Lo and Jasmina Hasanhodzic of the Massachusetts Institute of Technology offer another possibility for fee-wary investors. In "Attack of the Clones" (page 54) — part of a new *Alpha* series we call "In Theory" — Lo, who works at a hedge fund firm he founded when he isn't teaching finance at MIT, and Hasanhodzic, a Ph.D. candidate, present a way to replicate hedge fund returns using buy-and-hold portfolios of common risk factors like the Standard & Poor's 500 and U.S. dollar indexes. For strategies like convertible arbitrage, these "clone" portfolios perform almost as well as hedge funds — but at a lower cost and with greater transparency.

May the clone wars begin.

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